NOT INTENDED FOR PUBLICATION
UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

IN THE MATTER OF:	:	**CASE NUMBERS**
JAMES STEPHEN QUAY, Debtor. ______________________________	:	BANKRUPTCY CASE NO. 03-63644-WHD
BARRY FISHER, in his capacity as receiver for PCO, INC. And PERSONAL CHOICE OPPORTUNITIES, Plaintiff,	:	ADVERSARY PROCEEDING NO. 04-6065
v.	:	
JAMES STEPHEN QUAY, Defendant.	:	IN PROCEEDINGS UNDER CHAPTER 7 OF THE BANKRUPTCY CODE

O R D E R

Currently before the Court is the Motion for Summary Judgment of Barry Fisher, in his capacity as receiver for PCO, Inc. and Personal Choice Opportunities (hereinafter the "Creditor"). The Creditor's Motion arises from a Complaint to Determine Dischargeability of Debt and Objecting to the Discharge of James Stephen Quay (hereinafter the “Debtor"). As such, this matter is a core proceeding which falls within the subject matter jurisdiction of the Court. *See* 28 U.S.C. §§ 157(b)(2)(I);(J); 1334.

FINDINGS OF FACT

The Creditor was appointed in 1997 in an action styled *People v. Laing*, no. BC170157 (Los Angeles County, California, Superior Court) as the receiver for a company known as PCO, Inc. and Personal Choice Opportunities (collectively referred to herein as "PCO"). Creditor's Statement of Undisputed Facts, ¶ 1. PCO was created, controlled, and owned by David Laing. *Id*. ¶ 6. PCO was a nationwide Ponzi scheme that received nearly $90 million from investors and resulted in arrests being made by the Federal Bureau of Investigation. *Id*. ¶ 2. The Creditor was appointed for the purpose of recovering the assets of PCO for the benefit of the investors and other participants in the PCO Loan Program. *Id*. ¶ 3. PCO purported to be in the business of engaging in viatical settlements. *Id*. ¶ 7.

Under the PCO Loan Program, PCO solicited investors to "loan" funds to PCO, which PCO was to hold in an escrow account and then use to fund "viatical settlements" with terminally ill life insurance beneficiaries. *Id*. ¶¶ 8-9. PCO promised its investors a return of 21% to 25%. *Id*. ¶ 10. PCO never reached any viatical settlements and never made a distribution of funds to the investors. *Id*. ¶ 11. Approximately $60,000,000 of the escrowed funds received from the investors were fraudulently distributed to Laing and others involved with the PCO Loan Program. *Id*. ¶ 13.

In 1996, the Debtor contracted with Michael Smith of M.D. Smith & Company (hereinafter "Smith") for the purpose of acting as a broker for the PCO Loan Program. *Id*. ¶ 14. Pursuant to the terms of the agreement, the Debtor was to receive a commission, based upon a percentage of the investment funds raised. *Id*. The Debtor, individually and doing business as Faith Management Company (hereinafter "FMC"), solicited investors for the PCO Loan Program and received commissions from Smith shortly after submitting PCO investment packages and invested funds. *Id.* ¶¶ 15-16. The funds received by the Debtor as commissions were proceeds of the funds invested by the PCO Loan Program participants, which were unlawfully obtained by PCO. *Id.* ¶ 17. The payment of the commissions to the Debtor was made with the actual intent to hinder, delay, and defraud PCO's creditors. *Id.* ¶ 18. The Debtor provided no consideration for the payment of the commissions. *Id.* ¶ 19.

Several individuals involved with PCO have pleaded guilty to various criminal charges arising from the PCO Loan Program. *Id.* ¶¶ 22-24. The marketing materials for the PCO Loan Program contained statements that were entirely false and were made intentionally. *Id.* ¶¶ 26-27. The Debtor distributed these marketing materials while soliciting investments for the PCO Loan Program. *Id.* ¶ 27. The PCO investors relied upon these statements in investing over $90,000,000 in the PCO Loan Program. *Id.* ¶ 30. As a result of this reliance, the investors lost the entire $90,000,000 investment. *Id.* ¶ 31.

The Creditor initiated several lawsuits in order to avoid as fraudulent transfers payments of PCO Loan Program proceeds to entities and individuals, including the Debtor. *Id.* ¶ 32. The Creditor filed suit against the Debtor in the District Court for the City and County of Denver, Colorado (hereinafter the "Colorado Action"). *See Fisher v. Rambach, et al.*, Case No. 00 CV 1503 (District Court, City and County of Denver, Colo.). Within the Colorado Action, the parties conducted discovery, the Creditor moved for summary judgment, and the Debtor responded to the Creditor's motion for summary judgment. *Id.*

¶ 34. Following a discovery dispute, the state court judge granted the Creditor's motion to compel discovery and ordered the Debtor to produce certain documents. *Id.* ¶ 37. The state court deemed the Debtor's subsequent response to be incomplete and, after having allowed the Debtor one more opportunity to comply, the state court sanctioned the Debtor for noncompliance. *Id.* ¶¶ 39-40. Following the filing of a second motion for sanctions and default judgment, the Debtor filed a voluntary petition under Chapter 7 of the Bankruptcy Code. The state court stayed the action until the Creditor obtained relief from the automatic stay and permission to proceed to trial in the state court. *Id.* ¶ 43. At that time, the Creditor filed a renewed motion for sanctions and default judgment, which the state court granted. *Id.* ¶ 44. As a discovery sanction, the state court struck the Debtor's answer and entered a default judgment against the Debtor in the amount of $216,641.13 (hereinafter the "Colorado Judgment"). *Id.* ¶¶ 45-46.

On March 4, 2004, the Creditor filed a complaint objecting to the Debtor's discharge and to the dischargeability of the Colorado Judgment on the basis that the Debtor incurred the debt through false pretenses, false representations, or actual fraud. On December 15, 2004, the Creditor filed the instant motion for partial summary judgment. In the motion, the Creditor seeks entry of a judgment as to the dischargeability of the Colorado Judgment and as to the Creditor's objection to the Debtor's discharge. The Debtor has responded to the Creditor's motion, but has not specifically controverted the Creditor's Statements of Undisputed Fact. Accordingly, the Court must deem these facts to be admitted. *See* BLR 7056-1(b)(2) ("All material facts contained in the moving party's statement which are not specifically controverted in respondent's statement shall be deemed admitted.”).

CONCLUSIONS OF LAW

A. *Summary Judgment Standard*

In accordance with Federal Rule of Civil Procedure 56 (applicable to bankruptcy under FED. R. BANKR. P. 7056), this Court will grant summary judgment only if "there is no genuine issue as to any material fact and . . . the moving party is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(c). A fact is material if it might affect the outcome of a proceeding under the governing substantive law. *Anderson v. Liberty Lobby, Inc.,* 477 U.S. 242, 248 (1986). A dispute of fact is genuine "if the evidence is such that a reasonable jury could return a verdict for the nonmoving party." *Id.* The moving party has the burden of establishing the right of summary judgment, *Clark v. Coats & Clark, Inc.*, 929 F.2d 604, 608 (11th Cir. 1991); *Clark v. Union Mut. Life Ins. Co.*, 692 F.2d 1370, 1372 (11th Cir. 1982), and the Court will read the opposing party's pleadings liberally. *Anderson*, 477 U.S. at 249.

In determining whether a genuine issue of material fact exists, the Court must view the evidence in the light most favorable to the party opposing the motion. *Adickes v. S.H. Kress & Co.,* 398 U.S. 144, 157 (1970); *Rosen v. Biscayne Yacht & Country Club, Inc.*, 766 F.2d 482, 484 (11th Cir. 1985). The moving party must identify those evidentiary materials listed in Rule 56(c) that establish the absence of a genuine issue of material fact. *Celotex*

Corp. v. Catrett, 477 U.S. 317, 323-24 (1986); *see also* FED. R. CIV. P. 56(e). Once the motion is supported by a *prima facie* showing that the moving party is entitled to judgment as a matter of law, the party opposing the motion must go beyond the pleadings and demonstrate the existence of a material issue of fact that precludes summary judgment. *Celotex*, 477 U.S. at 324.

B. *Non-Dischargeability Under Section 523(a)(2)(A).*

1. *Elements of the Claim*

The concept of discharging pre-existing debt forms one of the most primary tenets of bankruptcy policy. Indeed, "a central purpose of the Code is to provide a procedure by which certain insolvent debtors can reorder their affairs, make peace with their creditors, and enjoy 'a new opportunity in life with a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt.'" *Grogan v. Garner*, 498 U.S. 279, 286 (1991)(citations omitted). At the same time, however, a separate equitable policy mandates that any such mechanism for an unencumbered fresh start only should redound to the benefit of those debtors who are unfortunate, yet honest. *Id.* at 286-87. In light of these competing policy goals, Congress included the following provision in the Bankruptcy Code:

> (a) A discharge under section 722, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor of any debt--
>
> * * * *
>
> (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by--
>
> (A) false pretenses, a false representation, or

actual fraud

* * * *

11 U.S.C. § 523(a)(2)(A). Thus, through § 523(a)(2)(A), the Code offers a means of denying those individuals who do not qualify as "honest but unfortunate debtors" the benefits of a fresh start. *Id.* at 287. Like other exceptions to discharge, however, the provisions of § 523(a)(2)(A) warrant narrow construction. *Gleason v. Thaw*, 236 U.S. 558, 562 (1915); *Schweig v. Hunter (In re Hunter)*, 780 F.2d 1577, 1579 (11th Cir. 1986). The creditor bears the burden of establishing non-dischargeability under § 523(a)(2)(A). *Hunter*, 780 F.2d at 1579.

To establish that the debt at issue arose as a result of the debtor's false pretense or false representation, the creditor must prove by a preponderance of the evidence that:

> (1) the debtor made a false representation with the purpose and intention of deceiving the creditor;
>
> (2) the creditor relied upon the debtor's representation;
>
> (3) such reliance by the creditor was justifiable;
>
> (4) the creditor suffered a loss as a result of that reliance.

See City Bank & Trust Co. v. Vann (In re Vann), 67 F.3d 277, 279-84 (11th Cir. 1995); *see also Grogan*, 498 U.S. at 285-90; *Signet Bank v. Keyes*, 959 F.2d 245 (10th Cir. 1992); *Mfr. Hanover Trust Co. v. Ward (In re Ward)*, 857 F.2d 1082, 1082 (6th Cir. 1988).

Additionally, in *McLellan v. Cantrell*, the Seventh Circuit Court of Appeals held that, pursuant to § 523(a)(2)(A), debts resulting from the commission of actual fraud by the debtor may be nondischargeable notwithstanding the fact that the debtor made no representation to the creditor. *See McLellan v. Cantrell*, 17 F.3d 890 (7th Cir. 2000). In *McLellan*, the debtor purchased certain property in which the creditor had a security interest. The creditor sued the debtor to recover the property, alleging that the debtor obtained the property for $10 and subsequently sold it for $160,000. While the fraudulent conveyance suit was pending, the debtor filed a petition under Chapter 7 of the Bankruptcy Code. The creditor filed a complaint in the bankruptcy court, seeking a determination that the debt owed by the debtor to the creditor was nondischargeable pursuant to § 523(a)(2)(A). *Id*. at 891. The bankruptcy court dismissed the complaint for failure to state a claim on the basis that the debtor had made no material misrepresentation to the creditor.

On appeal, the Seventh Circuit Court of Appeals held that, although most § 523(a)(2)(A) cases involve fraud by misrepresentation, "section 523(a)(2)(A) is not limited to 'fraudulent misrepresentation.'" *Id*. at 893. The court reasoned that, "by distinguishing between 'a false representation' and 'actual fraud,' the statute makes clear that actual fraud is broader than misrepresentation" and recognized that actual fraud can consist of "'any deceit, artifice, trick, or design involving direct and active operation of the mind, used to circumvent and cheat another.'" *Id.* (citing 4 *Collier on Bankruptcy* ¶¶ 523.08[1][e] (15th ed.2000)). Finally, the court concluded that a scheme in which two actors conspire to hinder or delay one of the actor's creditors constitutes actual fraud upon the creditors. *Id*. The court distinguished an actual fraudulent conveyance -- a transfer made with the intent to hinder or delay creditors – from a constructively fraudulent conveyance – a transfer of property for inadequate consideration, noting that the former, but not the latter, would rise to the level of "actual fraud" within the meaning of § 523(a)(2)(A). *Id*. at 894. Under the court's analysis, the transferee of the property would be complicit in this fraud only if the transferee has "been a full and equal participant in [the transferor's] fraud." *Id*. at 894-95 (citing *Cenco v. Seidman & Seidman*, 686 F.2d 449, 452-453 (7th Cir.1982)). Assuming the creditor's allegations were true, the court found that a new debt arose in favor of the creditor when the debtor assisted the transferor in preventing the creditor from being paid from its collateral. The court noted that this new debt, which was distinct from the original debt (the loan from the creditor to the transferor), would not have existed but for the fraudulent actions committed by the transferor and the debtor. *Id*. at 895. Accordingly, the court concluded that the debt owed by the debtor to the creditor arose "by operation of law *from her fraud*." *Id*. (emphasis in original). "Because it was an actual fraud, the debt that it gave rise to is not dischargeable." *Id*. Under the analysis conducted by the court in *McLellan*, in order to establish that the transferee of fraudulently conveyed property committed actual fraud upon the transferor's creditors, the creditor must establish that: 1) the transferor conveyed the property with the intent to hinder or delay his creditors; and 2) the transferee was a "full and equal participant" in the fraud.

Here, the Creditor has moved for summary judgment on his § 523(a)(2)(A) claim on two grounds. First, the Creditor alleges that the Debtor made false representations that resulted in damages to the investors involved with PCO and that the Debtor committed actual fraud by soliciting investments with knowledge that the PCO Loan Program was a sham. Second, the Creditor asserts that the Debtor, as a transferee of fraudulently conveyed property, committed actual fraud on the PCO investors. The Creditor relies upon findings of fact made by the state court and contained within the Colorado Judgment to satisfy his burden of establishing that no material facts remain in dispute and, as a matter of law, he is entitled to judgment on his claims.

2. *Establishing the Elements of the Claim Through Collateral Estoppel*

As the Creditor notes, the doctrine of collateral estoppel, or issue preclusion, may prevent a bankruptcy court from re-litigating matters which actually and necessarily were decided as part of a prior court action. *See Grogan v. Garner*, 498 U.S. 279, 284-85 (1991); *In re Graham*, 191 B.R. 489, 493 (Bankr. N.D. Ga. 1996) (Drake, J.). In *League v. Graham* (*In re Graham)*, 191 B.R. 489 (N.D. Ga. 1996) (Drake, J.), this Court applied the doctrine of collateral estoppel, concluding that a previously entered state court default judgment for fraud precluded the Court from making its own determination as to whether the debtor incurred the debt fraudulently. The Court explained that application of the doctrine of collateral estoppel is mandated by the requirement that federal courts give full faith and credit to judgments rendered in state courts. *Id*. at 494 (citing 28 U.S.C. § 1738). Additionally, the Court concluded that, when dealing with a state court judgment, a federal court must determine the preclusive effect of that judgment by reference to the law of the state in which the judgment was rendered. *Id*. at 494; *see also In re Whelan*, 236 B.R. 495, 505 (Bankr. N.D. Ga. 1999) (Bihary, J.).

In this case, Colorado law controls the issue of whether the default judgment entered in the Colorado Action should be given preclusive effect. In *Sunny Acres Villa, Inc. v. Cooper,* 25 P.3d 44 (Colo. 2001), the Colorado Supreme Court held that "[i]ssue preclusion bars relitigation of an issue if: (1) the issue sought to be precluded is identical to an issue actually determined in the prior proceeding; (2) the party against whom estoppel is asserted has been a party to or is in privity with a party to the prior proceeding; (3) there is a final judgment on the merits in the prior proceeding; and (4) the party against whom the doctrine is asserted had a full and fair opportunity to litigate the issue in the prior proceeding. *Id*. at 47; *see also United States v. Schaeffer*, 245 B.R. 407 (D. Colo. 1999). The Court finds there is no question that the second element has been met, as the Debtor is the party against whom collateral estoppel has been asserted and he was a party to the prior proceeding.

As to the first element, the Court notes that collateral estoppel is applicable to both issues of fact and issues of law. *M & M Management Co. v. Industrial Claim Appeals Office of the State of Colorado,* 979 P.2d 574 (Colo. App. 1998) ("[W]hen an issue of fact or law is actually litigated and determined by a valid and final judgment, and the determination is essential to the judgment, the determination is conclusive in a subsequent action between the parties."). Within the Colorado Judgment, the court made the following findings of fact that are relevant to this Court's inquiry in the instant case: 1) the PCO Loan Program was a "ponzi" scheme in which it was anticipated by the principals of PCO that funds received from later investors would be used to repay a portion of the investments made by earlier investors; 2) in order to obtain these investments, individuals involved with the PCO Loan Program borrowed money from investors in exchange for the promise of payment of an interest rate of between 21% and 25%; 3) no funds were ever returned to the investors of the PCO Loan Program, but were instead fraudulently distributed to Laing and others involved with PCO; 4) the Debtor contracted with M.D. Smith & Company to broker the PCO Loan Program; 5) the Debtor solicited investments in the PCO Loan Program and received $214,641.13 in commissions from M.D. Smith & Company; 6) the commissions constituted the proceeds of the investments made in the PCO Loan Program; 7) the commission payments were made to the Debtor with the actual intent to hinder, delay, and defraud the creditors of the PCO Loan Program; and 8) the Debtor did not give any value in exchange for the commission payments. The state court also made the following conclusions of law, which are relevant to the Creditor's claims: 1) the Debtor violated California Government Code § 13975.1(b)(4)- (6); 2) the Debtor violated California Civil Code § 3439.04(a)-(b); 3) the Debtor violated California Civil Code § 3439.05; and 5) the Debtor violated C.R.S. § 38-8-105(1)(a)-(b).

The Creditor further argues that the state court must have made a factual finding that the Debtor had knowledge of the intent of the PCO principals to fraudulently convey the funds to him because the state court did not conclude that the Debtor was a good faith transferee of the funds. In support of this contention, the Creditor notes that the state court found, as a matter of law, that the Debtor violated California Civil Code § 3439.04. Under California law, a transferee of funds found to have been conveyed fraudulently can assert, as an affirmative defense, the fact that he lacked any knowledge of the fraudulent intent of the transferor. *See* California Civil Code § 3439.08(a). Therefore, the Creditor asserts that, in order to find that the Debtor violated § 3439.04 and enter a judgment in the Creditor's favor, the state court must have found that the Debtor was not a good faith transferee and took the funds with knowledge of the PCO principal's fraudulent intent.

The Court cannot make this conclusion on the basis of the judgment before it. In order to establish the avoidability of the transfer under § 3439.04, the Creditor was not required to allege or prove that the Debtor lacked knowledge of the transferor's fraudulent intent. "The issue of good faith under UFTA § 8(a) is a defensive matter as to which the defendants asserting the existence of good faith have the burden of proof." *In re Cohen*, 199 B.R. 709 (Bankr. 9th Cir. 1996). The Colorado Judgment does not specify whether the state court considered the Defendant's affirmative defense or that it made any findings of fact as to the existence or lack thereof. Even assuming that the Debtor raised this defense in his answer, the state court struck the answer and thus may have had no reason to consider the defense. Therefore, a finding that the Debtor did or did not have knowledge of the principals' fraudulent intent was not essential to the judgment, and the Court cannot assume that the state court made such a finding. *See, e.g., In re Moore*, 186 B.R. 962, 975 (Bankr. N.D. Cal. 1995) (under California law, "[w]here a given issue or defense is not raised in the prior proceeding, a default judgment does not operate as a conclusive adjudication so as to collaterally estop the defendant from raising the issue or defense in a subsequent proceeding").

As to the third and fourth elements, the Court must find that the Colorado Judgment constitutes a "final judgment on the merits" and that the Debtor was provided with a full and fair opportunity to litigate these matters. Whether a default judgment may constitute a judgment on the merits depends upon whether the matters at issue were "actually litigated." *In re Dunston*, 146 B.R. 269, 277 (D. Colo. 1992). "'Actual litigation' does not necessitate a full trial, but a full and fair opportunity for the defendant to present his case." *Id.* (citing *In re Austin,* 93 B.R. 723, 727 (Bankr. D. Colo. 1988)); *see also In re Blinder, Robinson, & Co.*, 162 B.R. 555 (D. Colo. 1994) (as "default judgments are not automatically excluded from preclusive effect," a default judgment entered as a result of repeated failures to cooperate in discovery would satisfy the requirements of issue preclusion). "[I]n deciding whether to apply issue preclusion, the bankruptcy court must make sure the important issues were litigated by looking at the entire record and not just the state court judgment." *Id.* In order to assure that the bankruptcy court's exclusive jurisdiction to determine whether debts are dischargeable is not inappropriately abdicated, the bankruptcy court must consider the extent to which the parties participated in the case or had the opportunity to participate in the case and the court's consideration of the evidence. *See In re Austin*, 93 B.R. 723, 728-29 (Bankr. D. Colo. 1988) (where the state court judge made "clear and certain findings" regarding "the elements of fraud, embezzlement, larceny, and false representation," the debtor had three separate chances to go to trial, but chose not to do so, and, by doing, the "debtor knowingly consented to the entry of a default judgment," the bankruptcy court found that the default judgment satisfied the requirement that the matters be actually litigated and that the debtor be afforded a full and fair opportunity to litigate the matters).

Having considered the record made in the Colorado Action and the procedural history, as laid out by the state court in its default judgment, the Court must conclude that the Colorado Judgment constitutes a final judgment on the merits and that the Debtor was provided with a full and fair opportunity to litigate the matters addressed by the Colorado Action. The Court notes that this is not a case in which a default judgment was entered due to a mistake of the parties or in which the defendant lacked notice of the proceeding and was denied due process. Here, the Debtor filed an answer to the Creditor's complaint, participated in the discovery process, responded to the Creditor's motion for summary judgment, and responded to the Creditor's motion to compel. The Debtor actively participated in the State Court Action as it moved through the various stages of litigation. The state court also gave the Debtor every opportunity to cooperate in discovery. The Debtor chose not to do so, which resulted in the state court's decision to strike the Debtor's answer. Following the entry of this discovery sanction, the state court entered a default judgment after having made clear findings of fact and conclusions of law. Therefore, the Court will consider the findings of fact and conclusions of law outlined above to have been established by the entry of the Colorado Judgment and will not require the Creditor to present evidence regarding these in connection with his claims.

3. *Application of the Established Facts to the Elements of the Claim*

As noted above, to succeed on his claim that the Debtor incurred the debt at issue as a result of false representations, the Creditor must establish that: 1) the debtor made a false representation with the purpose and intention of deceiving the creditor; 2) the creditor relied upon the debtor's representation; (3) such reliance by the creditor was justifiable; and (4) the creditor suffered a loss as a result of that reliance.

From the undisputed facts established by the Creditor's Statement of Undisputed Facts and the findings of fact that the Court has determined are entitled to preclusive effect, the Court finds that the Creditor has established all elements with the exception of the fact that the Debtor made the false representations with the intention of deceiving the PCO investors. The Creditor points out that the Court is empowered to infer from the totality of the circumstances that the Debtor possessed knowledge of the fact that the PCO Loan Program was a sham. In support of such an inference, the Creditor points to the fact that the Debtor is an attorney and an experienced business man who should have questioned the legitimacy of an investment that offered a 21-25% return and a low risk of loss. Additionally, the Creditor points to the fact that the PCO Loan Program did in fact turn out to be a sham in which none of the investment proceeds raised were ever distributed to investors and several of the principals of PCO and some of the individuals involved pleaded guilty to criminal charges. The Court is inclined to agree with the Creditor that certain "red flags" may have alerted the Debtor that the investment he was selling was not legitimate. That being said, the Court has insufficient evidence at this time to conclude that this is the case and that, if the Debtor was put on inquiry notice that the PCO Loan Program was a sham, he failed to make a reasonable investigation into the matter. Accordingly, the Court cannot conclude that the Creditor has met his burden of presenting evidence to establish all elements of his § 523(a)(2)(A) claim.

The Creditor also contends that the Debtor incurred this debt as a result of actual fraud because he received proceeds of a fraudulent transfer. To do so, the Creditor must establish that: 1) the transferor conveyed the property with the intent to hinder or delay his creditors; and 2) the transferee was a participant in the fraud, such that it could be said that the debtor engaged in "deceit, artifice, trick, or design involving direct and active operation of the mind, used to circumvent and cheat another." *McLellan*, 17 F.3d at 893.

Here, the entry of the Colorado Judgment has established that the principals of PCO made the commission payments to the Debtor with the intent to hinder or delay the creditors of the PCO Loan Program. This finding by the state court satisfies the requirement that the fraudulent conveyance at issue involve actual fraud, as opposed to constructive fraud. That being said, the Court cannot conclude from the record that the Debtor was a full and equal participant in the fraud.

As discussed above, the Court cannot find that the Colorado Judgment is entitled to preclusive effect on the issue of whether the Debtor had knowledge of the fraudulent intent of the PCO principals. Accordingly, the Creditor must rely upon the undisputed facts and uncontroverted evidence to establish this element. Again, the Creditor has pointed to evidence and undisputed facts within the record and urges the Court to infer from the totality of the circumstances that the Debtor must have had knowledge of the fact that the PCO Loan Program was a sham or, alternatively, that he exhibited a reckless disregard for the truth. As explained above, the Court finds that there is insufficient evidence to support such a conclusion at this time. The Court agrees with the Creditor's observation that it is unlikely that the Debtor would ever admit that he accepted the commissions with knowledge of the fact that the PCO Loan Program was a "ponzi scheme." Nonetheless, the Court is mindful of the fact that dischargeability exceptions should be construed narrowly and finds that a trial, during which the Court can weigh the credibility of witnesses and consider all evidence regarding the nature of the investment, would enable the Court to determine with greater accuracy whether the Debtor's protestations of ignorance are credible. Therefore, the Court must deny summary judgment on this basis.

B. *Objection to Discharge*

At its core, the bankruptcy process seeks to provide debtors with a discharge from their debt obligations. *See Dilworth v. Boothe*, 69 F.2d 621, 624 (5th Cir. 1934) ("One of the great objects of the Bankruptcy Act is to relieve an honest debtor of the oppression of his debts when he has surrendered all of his property to be converted into cash for distribution among his creditors."). Nevertheless, a variety of policy considerations simultaneously mandate that certain exceptions be made for those debtors who are undeserving of such a discharge. *Grogan v. Garner*, 498 U.S. 279, 286-87 (1991). Courts generally construe discharge exceptions "against the creditor and in favor of the debtor." *HSSM # 7 Ltd. Partnership v. Bilzerian (In re Bilzerian)*, 100 F.3d 886, 891 (11th Cir. 1996) (citation omitted); *Matter of Juzwiak*, 89 F.3d 424, 427 (7th Cir. 1996). The Creditor bears the burden of proving that the Debtor's discharge should be denied. *Turoczy Bonding Co. v. Strbac (In re Strbac)*, 235 B.R. 880, 882-83 (Bankr. 6th Cir. 1999) (citations omitted);

Wazeter v. Michigan Nat'l Bank (In re Wazeter), 209 B.R. 222 (W.D. Mich. 1997); *see also* FED. R. BANKR. P. 4005 ("At the trial on a complaint objecting to discharge, the plaintiff has the burden of proving the objection.").

Section 727(a)(3) of the Bankruptcy Code provides that a debtor must be granted a discharge unless the debtor has "concealed, destroyed, mutilated, falsified, or failed to keep or preserve any recorded information, including books, documents, records, and papers, from which the debtor's financial condition or business transactions might be ascertained, unless such act or failure to act was justified under all of the circumstances of the case." 11 U.S.C. § 727(a)(3). The plaintiff has the burden of proving the inadequacy of the debtor's records, but "[o]nce a debtor's records are determined to be inadequate, the burden is on the debtor to establish any justification therefor." *In re Strbac*, 235 B.R. at 880, 882-83.

According to the Seventh Circuit Court of Appeals,

> Section 727(a)(3) requires as a precondition to discharge that debtors produce records which provide creditors "with enough information to ascertain the debtor's financial condition and track his financial dealings with substantial completeness and accuracy for a reasonable period past to present." The provision ensures that trustees and creditors will receive sufficient information to enable them to "trace the debtor's financial history; to ascertain the debtor's financial condition; and to reconstruct the debtor's financial transactions." Records need not be kept in any special manner, nor is there any rigid standard of perfection in record-keeping mandated by § 727(a)(3). On the other hand, courts and creditors should not be required to speculate as to the financial history or condition of the debtor, nor should they be compelled to reconstruct the debtor's affairs.

Juzwiak, 89 F.3d at 427-28 (internal citations omitted). Thus, the Debtor has an obligation to provide sufficient accurate information so that the Creditor can gain an understanding of his pre-petition financial affairs. Whether a debtor has produced "adequate" records depends on the circumstances of a particular case. *See United States v. Trogdon (Trogdon)*, 111 B.R. 655, 658 (Bankr. N.D. Ohio 1990). "Considerations to make this determination include [the] debtor's occupation, financial structure, education, experience, sophistication and any other circumstances that should be considered in the interest of justice." *Id.*

In this case, the Creditor relies upon the Colorado Judgment, which the Court determined above is entitled to preclusive effect in this matter, to establish that the Debtor has concealed or destroyed records that are necessary for the Creditor to determine the Debtor's financial history and condition. In the Colorado Judgment, the state court found that the Debtor failed to produce: 1) complete income tax records for 1996 and 1997; 2) any records regarding a bank account that he had in the country of Belize in 1996 and 1997; and 3) records pertaining to income or commissions earned from the Aegis Company in 1996 and 1997. Additionally, the state court concluded that the Debtor "deliberately concealed, destroyed, falsified or failed to keep or preserve recorded information, including books, documents and records, from which hi [sic] financial condition or business transactions might be ascertained."

As noted above, § 727(a)(3) requires that the debtor preserve and produce "enough information to ascertain the debtor's financial condition and track his financial dealings with substantial completeness and accuracy for a reasonable period past to present." This information is necessary to allow the trustee and creditors to "trace the debtor's financial history; to ascertain the debtor's financial condition; and to reconstruct the debtor's financial transactions." In this case, the Colorado Judgment has established that the Debtor may have either concealed, destroyed, or merely failed to preserve these records, which arose from financial transactions occurring in 1996 and 1997, approximately five to six years before the Debtor filed his bankruptcy petition in March of 2003. It is not clear from the evidence in this case that these records were necessary for the trustee and creditors to ascertain the debtor's financial condition and to track his financial affairs for a reasonable period of time. The Court will give preclusive effect to the judgment's finding that the records were either concealed, destroyed, or not preserved and that the Debtor's financial condition and transactions might have been ascertained from these records. However, it does not appear that the state court fully considered the question of whether the Debtor preserved and produced other records that would have provided "enough" information to allow the trustee and creditors to reconstruct his financial transactions and history for a reasonable period of time. For this reason, and because the denial of the Debtor's discharge is such a harsh penalty, the Court will require the Creditor to proceed to trial on this matter.

CONCLUSION

Having carefully considered the Creditor's Motion and Brief, for the reasons stated above, the Court concludes that the Motion must be, and, hereby is **DENIED**.

IT IS SO ORDERED.

At Atlanta, Georgia, this _____ day of March, 2005.

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W. HOMER DRAKE, JR.
UNITED STATES BANKRUPTCY JUDGE